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Monetary policy shocks and productivity measures in the G-7 countries*

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Abstract. An implication of two-country international real business cycle models is that total factor productivity should be an exogenous stochastic process. Economic theories which feature labor hoarding, variable capacity utilization, and increasing returns predict that measured productivity shifts are not exogenous; instead, expansionary aggregate demand shocks should lead to an increase in measured productivity. For each of the G-7 countries, this paper measures quarterly aggregate total factor productivity for the domestic country and its rest-of-world (G-6) counterpart. In each case the domestic productivity measures are not strictly exogenous: expansionary U.S. monetary policy shocks, as well as other G-6 monetary policy shocks, lead to productivity expansions. The evidence indicates that international business cycle models are misspecified unless they feature endogenous productivity mechanisms.

Key words: Monetary policy shocks – Productivity – International real business cycles – Exogeneity tests

JEL Classification: E5, F4

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